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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 92-266
Rate Regulation	))	

REPLY COMMENTS OF CONTINENTAL CABLEVISION, INC.

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SUMMARY

Continental's Comments set forth a sensible means for implementing the letter and spirit of the 1992 Act. Basic service rates would be measured against benchmarks derived from markets which have sustained effective competition. Basic would be regulated by cities with the legal authority and other qualifications to certify their jurisdiction to the FCC, or by less formal means within cities which choose not to certify. Satellite tier service rates would be measured against benchmarks drawn from a broader sample -- all comparable systems -- in order for the FCC to identify "bad actors" who exceed the 95-97th percentile of rates. Cost of service regulation would be applied to services only as a safety valve against confiscation. Regulated equipment is the only aspect of service which the Act requires to be priced on the basis of cost. Equipment would be subject to the cost benchmark regulation detailed in Continental's appendices, and associated with the level of service for which the equipment is needed. Equipment should not be regulated if the operator unbundles the charge and compatible third party equipment is available.

By comparison, Comments of franchising authorities and the Consumer Federation of America (CFA) ignore most of the balanced tools and regulatory distinctions drawn by Congress, and distort the few they select to undermine Congressional intent.

CFA abandons the effective competition standard for

basic regulation in favor of a "global formulaic" approach intended to subject both basic and tier services to a pure cost analysis not intended by Congress. The formula is premised on fundamental errors: from a belief that plant can be activated without cost; to an assumption that the cable industry can finance future technology and current programming on 1986 rates; to the fantasy that declining premium revenues will sustain the industry after basic and tier rates are slashed.

The National Association of Telecommunications Officers and Administrators (NATOA) and its municipal allies accept benchmarks in name only, as a meaningless way station in a world of cost of service studies (COSS). In this version, prices could not rise within benchmarks without actual COSS, franchising authorities could drive prices down below benchmarks with actual COSS, but operators with above average costs would be left with only "normative" cost recovery. Cost of service regulation would import exactly the complexity, administrative inefficiencies, and distorted incentives which Congess directed the FCC to avoid. It would be still further distorted by the cities' distinct proclivity to assign overheads and common costs to everything but regulated services and equipment.

The cities further game the process by manipulating the definition of "effective competition" so as to exclude virtually all competition. They would replace the marketplace forces Congress preferred with a perpetual regulatory apparatus of benefit to local regulators but not to the public.

The National Association of Broadcasters (NAB) has offered an outrageous scheme intended to hobble cable (by limiting cable operators to a return on the replacement cost of hardware and on no other aspect of the cable business) while assuring NAB of a transparent pass through of retransmission consent fees.

None of these key comments draw the slightest distinction between basic and tier regulation. Some would even subject tiers to the control of local franchising authorities, by "delegating" a non-delegable FCC duty, or by "defining" basic to include tiers. This construct ignores the fundamental change made to S.12 in Conference -- stripping cities of control over satellite tiers and subjecting satellite tiers to bad actor complaint procedures rather than to comprehensive regulation. It would also submit the engine of national cable innovation -- the satellite tier -- to the distinctly parochial interests of cities not concerned with maintaining the incentives or ability of the industry to finance continuing innovation.

The procedures recommended by the franchising authorities begin with a massive, reflexive rollback of rates and tiers premised on undocumented suspicions about monopoly profits which are not borne out in Congessional findings. The processes are fraught with delay without regard to the impact on ongoing financial needs of an operator under review. They impose punitive measures of the type Congress specifically foreclosed.

They would have the Commission invite franchising authorities to abrogate state, contract, and federal limitations on their legal authority. Restraints on negative options and evasions would be so defined as to strip operators of flexibility in shaping tiers, selecting programming, or launching lifeline services; and to paralyze operators by the veto of a few. In all of this, franchising authorities would be immunized from liability; legally deferred to as "experts;" and insulated from political accountability by limiting the recovery of municipally-imposed costs and hiding the cost of franchise fees, PEG support, and other franchise costs from line itemization. This is a recipe for arbitrary confiscation.

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INTRODUCTION

Continental Cablevision hereby replies to the Comments filed in this proceeding.

I. GENERAL [¶4-5]

In its initial Comments, Continental sought to assist the Commission in the development of a rational, workable framework for rate regulation. We suggested a basic service benchmark approach based primarily on cable systems subject to effective competition and a satellite tier complaint process reflecting average current rates. This structure is fully consistent with the specific language and the overall goals of Section 623 of the 1992 Cable Act. Our approach would identify a benchmark of reasonable rates while preserving opportunities for innovation and expanding consumer benefits in a dynamic emerging cable industry.

By comparison, several commentators, including NATOA, NAB, CFA and their municipal allies, have advocated approaches which rent asunder the specifics of the law that passed in favor of politically-driven, outcome-oriented proposals that would leave the Commission in gridlock and produce unjustified, confiscatory rates for both basic and tier cable programming services.

NATOA, NAB, CFA and their municipal allies base their proposals on repeated charges of "oligopoly," "excess profits," and abuse, with a few supposedly damning statistics that cable <u>prices</u> have increased. Such comments build their case for universal rollback of basic and tier rates on common quicksand: the claim that Congress has found that all current rates contain monopoly profits which must be removed. NATOA claims (p.43), for example, "studies show that most cable rates contain monopoly rents." NATOA refers to Congress' "finding" rate increases for the lowest level of service amounting to 40% for 28% of subscribers. The finding reveals nothing about profits or affordability: A $2.00 increase in a $5.00 basic rate amounts to 40%, but may sacrifice a return for a quite affordable rate. Austin claims (p.7) that Congress determined that "rates would have to be reduced." However, the cited authority is to a far different statement: a requirement that satellite tier complaints be investigated, and the rates compared with reasonable business practices. Refunds are noted as a mere possibility. It is a quantum leap from Congressional targeting of "bad actors" to a universal rollback of all basic and tier rates for an entire industry.

The uncited studies, slurs, and focus on prices alone does nothing to reveal the level of or justification for profits, because they do not adduce meaningful evidence of valuation, costs or comparable competitive rates. All have assumed that a business' legitimate value can only equal the book value of hard assets, and that any greater valuation reflects illicit monopoly profits. Yet cable's legitimate valuation derives also from going concern, cash flow, and intangibles, as with businesses as competitive and diverse as real estate, entertainment, and grocers. Peat Marwick has previously reported that cable operators' profitability is less than or equal to the average profitability of publicly-traded non-financial institutions. Appexdix B. Many of the proposals have wrongly assumed that competition should eliminate even this cost of capital and reasonable profit. That alone should preclude application of such formulae under a statute which seeks to emulate competitive (not confiscatory) prices for basic rates.

II. EFFECTIVE COMPETITION [¶8-10]

In Continental's view, NATOA and its municipal allies are attempting to narrow the statute's definition of "effective competition" to suit their own political purposes. They suggest that a competitor cannot "count" as having "comparable" programming unless it has as many channels as cable. Yet the statute says nothing of comparable numbers of channels. Under the NATOA definition, MMDS operators, who have fewer channels available for license (33) than cable operators have average channels in place (41), could never present "effective competition." In reality, wireless is competing very effectively (in Corpus Christi, for example) and is being treated as a competitor for access-to-programming.

Austin insists that the competitor must offer the same "type" of programming. Not only is this not a statutory criteria but it would preclude clearly competitive HSD and DBS distributors from ever presenting "effective competition," because they do not carry local broadcast channels. NATOA tries a different means to define away HSD and DBS competition: by treating competition as not being "actually available" unless it advertises in local media, when the bulk of HSD advertising is in the national media like Satellite Orbit magazine.

Continental submits that the very penetration of a service is itself the best evidence of its actual availability. There is no need to supplement the statute with yet another test of consumer appeal. Anticipating that result, NATOA and its municipal allies seek to dilute measures of competitive penetration. Remarkably, NATOA insists that cable faces ineffective competition if 15% of subscribers find alternatives among more than one competitor to cable. NATOA has ignored the statute's reference to plural "distributors," the legislative history's comparable reference, and the fact that competition in a market with three competitors would probably be more robust than in one with two. Austin follows a similar tactic: it claims that competition available to 50% of the franchise area does not "count" unless there is perfect 50% overlap of homes passed. But if uniform rate structures are required within a franchise area, even a modest overlap should be sufficient to induce a competitive response.

NATOA plays the same game with MDUs. It requests that multiple subscribers in an MDU be counted as only one subscriber. This is one more attempt to define away competition, since SMATV and MMDS subscriber penetration is most likely to occur in MDUs. Bulk accounts should be counted at least on an equivalent basic unit (EBU) basis. They would most appropriately be counted on a total unit basis; otherwise, the EBU subscriber "count" would vary depending upon the particular price charged by each competitor, when it is the same MDU market.

NATOA is obviously seeking to devise tests which will preserve local regulatory authority at all costs, regardless of the presence of effective market forces to which the statute gives priority.

These are not merely games to retain jurisdiction. As we will see in Part IV.A, Austin uses them substantively, in an effort to define out of basic benchmarks the prices of competitive markets which they deem not low enough to sustain their demand for rollback.

III. BASIC SERVICE -- CONTENTS & REGULATIONS

A. Basic As A Mandatory Buy Through [¶11-12]

In the first of several efforts at overreaching, NAB advises that cable may not sell any service to customers without first selling the broadcast basic. This is a splendid example not just of doublethink but, by our count, of quadruplethink. NAB is simultaneously arguing that by removing satellite cable networks to create the broadcast basic service contemplated by Sec. 623(b)(7), operators are (1) creating "undesirable" basic service even when (2) the service is composed of the very broadcast signals which NAB elsewhere claims composes the principal value to consumers of cable. Further, NAB argues that (3) broadcasters must be protected from customers who would otherwise "buy around" the basic broadcast service in preference to cable services (4) even if that customer already receives broadcasting off-air, or from another source, or is seeking premium product as a supplement, or is ordering digital radio, interactive services, or other transactional services which do not even connect to the TV receiver. NAB is entitled at most to the literal protection given in the statute: mandatory buy through of basic to reach the satellite tier. Its efforts to artificially handicap cable must be rejected.

B. Only One Level of "Basic Service" Is Subject to Regulation Under Sec. 623(b) [¶13]

NATOA's overreaching is nowhere more apparent than its bid for jurisdiction over satellite cable programming tiers. NATOA does so directly by asking the Commission to "delegate" its jurisdiction over tiers to local governments. The statute, of course, denies franchising authorities any role in tier disputes except that of complainant -- never as judge. Hence, NATOA and its allies seek the same result indirectly by asking the Commission to define satellite tiers as multiple levels of basic service. According to the <u>ACLU</u> case, this would occur if the cable operator has merely done the math for customers and added the price of the tier to the price of the basic service which is a "must buy" under the Act. According to NATOA and Austin, it would also occur if so ordered by the franchising authority or if the invoice billed for "cable service" instead of itemizing every tier. Another variation is NATOA's request that discounted packages -- which extend real value to consumers -- be treated as "tiers" if they contain premium services.

Such a formalistic approach is a vestige of the 1984 Act or pure municipal overreaching. It cannot be reconciled with the 1992 Act's new definition of basic, its jurisdictional split of authority, or its buy through rules. Section 623, and its legislative history make clear that local jurisdiction is confined to "the" basic tier established under 623(b)(7), not to multiple tiers. Congress very specifically rejected the Senate version which would have given NATOA the power it now seeks through regulation. It granted exclusive jurisdiction to the FCC, following a clear line of authority from the 1972 Cable Report through Nevada and the 1984 Act.

Multiple tiers of basic are not compatible with the right to buy around a tier. The Act provides a right to access premium services after buying "the" basic tier, not the ones Austin finds convenient to identify in its multiple basic hypothesis. Indeed, the very premise of tier buy through is to make satellite tiers optional and to segregate their costs from the reduced cost of a smaller basic service. Austin's effort to force 60 channels onto basic is fundamentally inconsistent with the Act's intended purpose to unbundle satellite services from basic.

In Continental's view, nothing would be more detrimental to the national programming marketplace or more inconsistent with the dictates of the 1992 Act than to entrust regulatory authority over satellite programming with local governments. The Commission must resist municipal entreaties to grant them authority over any more than "the" basic tier defined in 623(b)(7).

C. Jurisdictional Division [¶14-16]

Many Comments would have the Commission assume direct regulatory responsibility for basic cable rates in all of the 30,000 franchise areas which do not "certify" their jurisdiction. Not only is this contrary to the Act (See Continental's Comments p.14-15), but it is administratively unnecessary. By adopting the basic benchmark rates proposed in our earlier Comments, and by limiting cost of service studies to a safety valve against confiscation, the Commission can minimize the administrative complexities which might discourage local certification, and provide local jurisdictions with ample opportunity to evaluate and regulate basic rates where they are so inclined.

D. Filing of Franchising Authority Certification [¶19-21]

NATOA glosses over the statute's plain demand that local franchising authorities certify their "legal authority" to apply the Commission's basic rate standards. NATOA believes that Congress can empower cities to regulate rates regardless of state and local restrictions. If Congress had done so, the statute would have made no reference to such a required showing of legal authority. Presumably, Congress would have also offered a constitutional explanation for ignoring the accepted limits on intrusion into the allocation of power within a state[1/], as it

1/ See discussion at L. Tribe, American Constitutional Law § 5-22 (2d ed.).

did for other significant departures. E.g., H. Rep. 58-74. As creatures of state law, franchising authorities must find in state and local law their "legal authority" to certify. Likewise, if they are parties to agreements not to regulate (as Continental illustrated in its Comments), they may not constitutionally abrogate those agreements, nor may the Commission empower them to do so.

Incredibly enough, Austin goes so far in stripping meaning from the statute's certification qualifications that it argues a city should be certified "even if it does not believe that it is qualified to be certified." Congress would not have imposed standards of certification if every city in America qualified merely by virtue of its corporate status.

NATOA suggests that the Commission is the default regulator of basic for all uncertified communities. Yet Section 623(a)(6) limits the Commission to exercising "the franchising authority's jurisdiction." Furthermore, that power is granted only on a temporary basis, in circumstances where the franchising authority already has the "legal authority" and has filed a temporarily ineffective certification. The statute does not authorize the Commission to expand its jurisdiction beyond this. Nor should the Commission permit franchising authorities who lack the underlying legal authority to file deliberately defective certificates in an attempt to end run contractual, state, and federal jurisdictional limitations.

NATOA also contends that the absence of effective competition should have no bearing on certification, because effective competition does not appear as a certification standard in Section 623(a)(3). By the terms of Section 623(a)(2), the absence of effective competition is the jurisdictional predicate for any regulation. It would be a colossal waste to permit certification or its aftermath in competitive markets. Administrative efficiency is a statutory goal. It can best be achieved as Continental suggested in Comments, by pre-filing notices and with threshold motions to avoid the apparatus of rate regulation in markets facing effective competition.

E. Joint Regulation

NATOA and Austin seek the right to engage in joint certification not only among franchising authorities served by a single system but among local authorities seeking to build an inter-jurisdictional tribunal over multiple operators. We have previously explained that unless a common franchise has been granted, and thus common obligations incurred, joint certification would force fit a system with divergent costs into a single homogenized mold. It would also enormously complicate the ability of a franchisee to work out informal settlements with franchising authorities. The cities' new request that the Commission endorse still wider expansion of a franchising authority's jurisdiction would take the Commission into territory entrusted to state legislatures. State legislatures can empower municipalities to enter into joint powers agreements, as is done in Northern Dakota County (Minnesota). But state legislatures often limit the scope of such pacts. Minnesota, for example, abolished its state cable commission. It is not for the Commission to "empower" cities to form new governmental entities which state legislatures have denied to them.

IV. BASIC RATE STRUCTURE

A. Standards [¶34-61]

1. CFA

During consideration of the 1992 Act, CFA launched a celebrated defense of the "effective competition" standard for basic rates. Its dubious estimate of a $6 Billion savings to consumers if basic rates were set at the level of competitive markets gained rapid currency. Now, amidst 161 pages of Comments, barely a page (84-85) is spent on comparing basic cable rates with rates in markets with effective competition, and the $6 Billion estimate is nowhere to be seen. Instead, CFA advances an entirely new "global formulaic" approach to advance "the ideal regulatory scheme [which] would deliver all cable channels at cost" (p.15). This oversimplification takes a standard Congress applied <u>only</u> to regulated equipment and extends it to cable service rates Congress never intended to be set "at cost." CFA ignores virtually every other statutory standard, including administrative efficiency, the comparison of rates to similarly situated systems, and the balancing of interests (such as the future of diverse and creative programming).

The specifics of CFA's "global" formulaic approach are founded on fundamental, basic errors. CFA assumes that cable operators have incurred no increased programming or operational costs since 1986. It assumes that activation of new plant carries no cost. It assumes that the formula should prohibit increases in price even when additional services are added. It assumes that the cable industry will be able to finance future technology and programming at 1986 basic rates. These assumptions are absolutely false. To adopt a formula which codifies them will create a straightjacket for innovation and incentives to remove programming in order to achieve price increases otherwise forbidden by CFA's formula.

CFA's methodological innovation of "weighting" programs by quality merits special comment. It would entrust the government with the subjective evaluation of the contents of expression -- a role contrary to both the First Amendment and to the Communications Act. It would also eliminate from cable policy any opportunity for niche programming to flourish, and replace the promise of programming diversity with the mass appeal broadcast product which cable has transcended. Continental submits that CFA's proposal is rooted in an unwillingness to live with the Act which Congress did pass, and must be rejected by the Commission.

2. NATOA

NATOA is in basic agreement with Continental that benchmarks drawn from markets which have sustained effective competition should be the basis for basic service regulation. However, its procedural implementations would defeat the very purpose of those benchmarks. NATOA would insist, for example, that an operator could not "unilaterally" adjust its rates up to benchmark if basic rates were below them. No adjustment would be permitted even as part of a revenue neutral basic/tier price adjustment, or to pass through third party programming increases over which the cable operator had no control. Adjustments -- even within benchmarks -- would require a cost of service study. It would, unlike CFA, permit a high cost operator to exceed benchmarks after an appropriate showing that costs exceeded benchmarks; but it insists on the "reciprocal" right of franchising authorities to reduce rates which are within benchmarks by opening up a cost of service/rate of return rate case.

This conceptual construct would destroy the benchmarking system. By definition, benchmarks drawn from competitive markets fully protect consumers by extending to them the rates which would apply in competitive markets. Benchmarks do so without the need for cost of service studies or the tortuous development of an appropriate "rate of return" on the cable and programming business. Consumers suffer no harm if rates are within benchmarks, because they obtain all of the benefits available in competitive markets. The notion that consumers deserve better, if an operator's "cost" of service is still less, reflects a classical utility ratemaking mindset, coupled with a belief that returns should be razor thin, which will plunge regulators back into cost of service studies. With them would come the attendant disincentives for programming, innovation, creativity, and economies which benchmarks are designed to replace.

Continental disagrees with the CFA notion that creating a right to demand rates below benchmarks is required for "symmetry." A high cost cable operator has a constitutional right to recover those costs, if he is willing to undertake the difficult path of a rate case. Creating a "symmetrical" right of the government to apply cost of service standards to operators within benchmarks assumes a nonexistent reciprocal "right," would seek to provide consumers with a rate which would not arise in a competitive market, and would make benchmarks a meaningless point in a world driven by complex cost of service regulation.

Ultimately, CFA seeks to cast aside the statute and a true benchmark approach in favor of its politically-driven argument to lower rates as much as possible, regardless of the 1992 Act or constitutional imperatives.

3. NAB

NAB's contribution to the rulemaking is to recommend that cable be restricted to a modest return on the replacement value of assets and act only as the transparent billing conduit for programming and operating costs, without return. As previously explained in our Comments, many operators pay considerably more than book -- and even more than replacement value -- in order to capture unrealized economies and the going concern value of assets fully organized and ready for business. NAB's proposal would simultaneously strip operators retroactively of that investment; remove them from any role in assembling programming -- the value broadcasters repeatedly ascribe to assembling a broadcast day; and remove from cable the rewards (and incentives) for innovation and creativity. Its obvious goal is to assure broadcasters an untrammeled right to flow through retransmission consent fees to cable subscribers, while simultaneously hobbling growth of new cable services. Given NAB's long history of efforts to restrain the growth and development of cable, this latest cynical foray should come as no surprise. If the Commission accepted the NAB economic approach, we assume that the Commission should also limit broadcast station sales prices to the replacement cost of the transmitter, less the value of the public spectrum. Of course, the cost of broadcast programming would flow through without markup to subsequent purchasers of advertising time.

4. Austin

Austin professes a greater allegiance to measuring current basic prices against prices in markets with effective competition, but it has so gamed the selection of benchmark markets as to produce a result at war with reality. Continental has noted above how Austin has sought to exclude from the definition of "effective competition" most markets which are subject to it. In its appendices, Austin abandons any pretense of honest reporting and simply eliminates from its computation of competitive benchmarks those overbuilds with rates higher than Austin would like. Austin's lame explanation -- that Orange County, for example, is under purchase agreement -- ignores the fact that the overbuild rates increased dramatically well before the collapse of the overbuild.[2/] Excluding competitive markets merely because the rates are high is unfaithful to the term and purpose of the Act. The Act does not say that basic rates should

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2/ Kagan reported that Orange County rates increased from \$7.95/\$8.95/\$11.95 for the three operators to \$18.95/\$17.95/\$20.70 by early 1992, well before the Central Florida overbuild sold out. Cable TV Franchising, June 28, 1991; April 30, 1992. Wall Street Journal, Dec. 10, 1992.

be measured against "markets subject to effective competition <u>and</u> really low rates."

5. Cost Allocation

Many of the details of the NATOA and Austin proposal for basic rate standards reflect a similar effort to dodge the terms of the Act and to escape the financial consequences of local demands placed on cable through the franchising process. For example, NATOA's effort to trivialize the costs of public, educational, and governmental access support is really an effort to place those costs anywhere but in my back yard. PEG costs are not minor. They can amount to 5% of an operator's gross revenues, and even more in grandfathered franchises. But NATOA would have that access support stripped of any compensation for overhead -- when many franchises require that system offices be sufficient in size, staffing, support and overhead to also sustain colocated access studios. Those costs have to be recovered somewhere, and the Act provides that they are to be recovered in basic service. Sec. 623(b)(2)(C)(vi), 623(b)(4). H. Rep. 83 ("amounts required to satisfy franchise requirements for the support of public, educational and governmental (PEG) channels, or amounts for the use of such channels"); H. Rep. 84 ("actual amortized costs of facilities, equipment and services provided by the operator to support PEG channels"). The NIMBY approach is just one more effort to hide the costs from basic